FIRE INSURANCE RATES AND METHODS

In the spring of 1902, the price of fire insurance throughout this country suddenly rose 25 per cent. During the ensuing hubbub the fire insurance companies furnished ingenious explanations, and waited for the storm to blow over. For the remaining months of 1902, alone, this increased charge for insurance produced about sixteen million dollars more income to the companies.

This sudden rise in the price of fire insurance was due to the application by the companies of the old principle of charging "all that the traffic will bear." Evidences of commercial prosperity, displayed on all sides, could not but excite the cupidity of corporations manifestly in business for the benefit of their exchequer. A conclave of prime-movers in the insurance world was held, at which the formula was adopted that "the insurance companies, for years, having lost much money, it is imperatively necessary to raise rates 25 per cent and said raise goes into effect immediately." No esoteric meaning attached to the words "we are losing money." They were explained as meaning that the profits realized from the employment of capital in the fire insurance business were inadequate to keep that capital from flowing to other more remunerative industries. What are the facts of the case?

From the tables presented at the annual meeting of the National Board of Fire Underwriters on May 14, 1903, it is found that the paid dividends of the American joint-stock fire insurance companies combined have averaged from 1860 to 1902, inclusive, not less than 11.14 per cent. Since 1892, the yearly averages have been as follows:

Year.	Per ct.	Year.	Per ct.
1892	10.51	1898	11.64
1893	10.43	1899	11.65
1894	10.60	1900	11.18
1895	11.40	1901	11.63
1896	11.24	1902	11.96
1897	11.33		

So that the average dividends of the last eight years have been higher than the average of the last forty-two years, and the dividends declared in 1902 were the largest since 1860.

Turning to the market price of fire insurance companies' stocks, the investigator is confronted with symptoms of decided prosperity. The Insurance Year Book for 1903 (published by the Spectator Company, New York), on pages 180 to 187, quotes the "latest sale of stock (per cent)" of 139 American fire insurance companies. These selling prices fall into the following subdivisions:

$100	Stock selling below 100	1
	Stock selling at 101-150	65
	Stock selling at 151-200	25
	Stock selling at 201-300	23
	Stock selling at 301-400	13
	Stock selling at 401-1400	12
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Can anything be discovered in these prices warranting disappointment or pessimism?

It should be remembered that the income of the fire insurance companies is derived mainly from two sources: underwriting and investment of funds. So that dividends on capital invested are declared out of the profits accruing either primarily from the underwriting, or secondarily from the investment of funds. An underwriting loss arises when the indemnity paid out for loss by fire and the expenses of management together exceed the income derived from premiums for the indemnity furnished.

The alleged total underwriting "loss" of all American companies in 1901 is an elusive quantity; but the insurance companies seem to have agreed to give it as "considerably over six million dollars." For argument's sake we might assume that this statement is truthful. It would then follow that the dividends declared by these companies in 1901 arose from profits derived from the secondary sources of income, after making good the alleged underwriting loss of $6,000,000. In other words, if the primary source of income showed a debit of $6,000,000, so that a dividend of 11.63 per cent was declared out of profits derived from the secondary sources of income, it is obvious that but for this debit of $6,000,000 total dividends of 22.54 per cent could have been paid on the capital of $55,000,000. Either one of two things follows: when telling the public "we are losing money," the fire insurance companies really meant "we are losing money on one of our sources

of income though from our secondary sources of income we are making very much money," or else they were distributing unearned dividends. That they were guilty of this illegal act is not probable. So far, then, it seems that there was but little reason, if any, for increasing the fire insurance burdens of this country 25 per cent.

The business of fire insurance in this country is not only highly profitable, but is profitable in spite of an extravagance and a waste of money which in any other industry could not be tolerated. The combined American and foreign joint-stock fire insurance companies doing business in the United States entered into contracts for contingent indemnity, or, to use the technical phrase, wrote the following aggregate amount of risks:

In 1902	$21,320,333,036
In 1900	19,130,399,000
An increase of	$2,189,934,036, or 11½%

They paid out for "commissions and brokerage":

In 1902	$37,628,785
In 1900	29,705,775
An increase of	$7,923,010, or 26 2-3%

In other words, in order to increase sales of indemnity by 11½ per cent, the companies actually increased the commissions paid to their agents by 26 2-3 per cent.

Any competitive industry which treated its traveling representatives, or sales agents, similarly, would be guilty of foolishness or excessive generosity, and in either case, would be inviting bankruptcy. The peculiar extravagance of this method of doing business is more apparent when consideration is given to the following figures. The consideration or price, or, technically speaking, the premiums charged for writing the foregoing risks, was:

In 1902	$185,494,632
In 1900	146,263,565
An increase of	$39,231,067

So that, out of an increased income of about thirty-nine millions, eight millions went to brokers. In other words, over 20 per cent of the increase of money arbitrarily taken from the public went

immediately into the pockets of insurance brokers. This, it should be remembered, happened at the very time when the public all over the country was being told that "the companies were losing so much money that there was nothing left to do but to raise the price of insurance 25 per cent"!

This immense drain for commissions, made upon the whole business community, is not only excessive and unreasonable, but it is a condition of affairs which has been steadily growing worse for the last forty years. In fact, for every policy or contract promising indemnity to the amount of $100, there was paid as "commissions and brokerage" the following sums:

In the years 1860-70, an average of	10.5 cents
In the years 1871-80, an average of	13.9 cents
In the years 1881-90, an average of	15.6 cents
In the years 1891-1900, an average of	15.8 cents
In the year 1901, an average of	16.6 cents
In the year 1902, an average of	17.7 cents

It will be seen that the payment to the insurance broker has steadily and persistently grown, until it is to-day greater than at any time since 1860, and this in spite of the fact that the public is much more desirous of insurance and more than ever accustomed to assume the duties which should really be fulfilled by the broker.

So far, then, it is found that dividends paid on the capital invested in the fire insurance business, and the commissions paid to agents, are higher to-day than at any time during the last forty-two years. Now, it will be admitted that the prime function of fire insurance is to indemnify the public against loss by fire. We have seen that in 1902 all the United States[1] companies combined made the following payments:

For "commissions and brokerage"	$26,548,587
For "dividends"	6,554,570
Total	$33,103,157

These thirty-three millions, of course, came out of the pockets of the insured. Besides the $33,000,000 above accounted for, there were other expenditures incurred in the conduct of fire insurance in this country the disbursements for which were drawn also directly

[1] As the dividends paid by foreign companies transacting business in the United States are in a great measure dependent on the results of European underwriting, they cannot serve as a criterion of conditions in this country, and therefore are not considered.

from the pockets of the public. Over fourteen million five hundred thousand dollars were paid out for sundry expenses by these same companies in 1902. So that, in that year, these American companies combined actually retained $47,644,000 for themselves, their agents, and their expenses, and, as indemnity to the public, they paid—how much?—less than sixty-six million dollars! Yet every penny of this money was furnished by the insuring public!

What would be thought of the methods of a savings bank which could say to the public: "We shall allow you to deposit your savings in our bank and you will be allowed to draw on your account at sixty days' sight,[2] on condition that for every $114 which you deposit, we shall be allowed to retain $48 for ourselves, this sum to be retained by us not for a certain short time but for all time"? That, in a crude way, illustrates what the American fire insurance companies said to the public of the United States in 1902. They even went further, as will be shown.

From 1860 to 1902, inclusive, the average yearly premium on a policy of $10,000, charged by all the joint-stock fire insurance companies doing business in the United States, has been as follows:

Years.	
1860-70	$80.32
1871-80	94.32
1881-90	98.80
1891-95	106.40
1896-1900	101.48
1901	106.05
1902	115.18

It will be seen that the price charged for furnishing insurance to-day is much higher than at any time in the last forty-two years. Leaving this phase of the matter out of the question for the time being, one finds further that during the same periods these contracts of insurance involved the fire insurance companies in the following losses by fire for every $10,000 of risk assumed by them:

Years.	
1860-70	$46.55
1871-80	50.60
1881-90	48.70
1891-95	51.67

[2] According to insurance policies, losses are payable at any time within sixty days after ascertainment thereof, though, in justice to the companies, it is only fair to say that in general they do not avail themselves of the full delay accorded to them.

Years.	
1896-1900	$42.92
1901	45.15
1902	44.17

It will be noted that fire insurance losses are not growing worse.

The difference between the amount deposited by the public with the insurance companies and the amount refunded by these companies constitutes the gross residue retained by the companies for exercising the privilege of being trustees of, and depositaries for, the public's funds. The public's share of its own premiums compares with the companies' share thereof as follows:

Years.	Returned to Public.	Gross Residue of Charge to Public.
1860-70	$46.55	$33.77
1871-80	50.60	43.72
1881-90	48.70	50.10
1891-95	51.67	54.73
1896-1900	42.92	58.56
1901	45.15	60.90
1902	44.17	71.01

The premiums charged to the public have been such as to permit a continually growing sum to be at the disposal of the companies, for some purpose or other, after reimbursing the public for losses suffered. However, that is a detail; the main fact which we wish to keep in mind is this: last year (1902) the average charge for a policy of insurance for $10,000 was $115.18 and under this same policy there was paid out an average indemnity of $44.17. The public made a deposit of $115.18 and of this sum drew out $44.17. The trustees kept the change.

Lest it may appear incredible that such a condition of affairs really existed, the following corroborative figures are reproduced from the latest report[3] (1903) of the Insurance Commissioner of Connecticut. It should be remembered that the figures given are compiled by the Insurance Commissioner of Connecticut, from the sworn statements of the companies themselves. They cover the operations of all the representative American stock fire insurance companies and, for reasons already given, do not cover the operations of European companies transacting business in this country.

[3] Any one can obtain this report for the mere request. The figures will be found on pages 689 to 698. Reports published by almost any other state will furnish the same information, though in somewhat less convenient form.

INCOME during the year ending December 31, 1902:

Fire premiums, net	$128,424,000	
Marine " "	4,887,000	
Total		$133,311,000
Interest on bond and mortgage		1,356,000
Other interest and dividends		6,351,000
Rents		850,000
All other sources		4,500,000
Total income		$146,368,000

OUTGO during the year ending December 31, 1902:

Total losses	$64,383,000
Dividends	6,021,000
Commissions and brokerage	25,494,000
Salaries and fees	7,770,000
Taxes	3,334,000
All other disbursements	9,519,000
Total outgo	$116,521,000

The foregoing figures represent the joint operations of practically all the American fire insurance companies. They show that after paying all the losses of the year, after paying out half as much as the losses merely for dividends and commissions, after paying out all the disbursements, the total income exceeded the total outgo by about thirty million dollars. Now, the aggregate paid-up capital of the companies in question was, in round figures, $47,000,000, so that this excess of total income over total outgo would suffice to pay further dividends of about 63 per cent on the paid-up capital.

It will be said that much of this $30,000,000 is not necessarily an item of profit, but that it represents, in fact, the sum of premiums which have not been fully earned. Let us see how accurate this is. The law requires fire insurance companies to have on hand an "unearned premium fund," amounting to one-half of what is paid in to them, so that a policyholder canceling a policy may be reimbursed the ratable portion of the premium paid. This liability is constantly being incurred, and constantly being removed. For the dollars which at this moment are being impounded, there are the dollars being released, which were put in escrow, as it were, a year ago. Thus, the "liability reserve" can only be considered to affect our statement in regard to that portion of the above $30,000,000

which corresponds to an increase of business. If, in this month, a company receive as premiums $1,100 for every $1,000 which it received in the corresponding month of last year, it is evident that under the provisions of the law, for every $1,100 which it impounds to-day it can release but $1,000 of fully earned premiums. Now, the natural increase of business does not materially affect this $30,-000,000. Let it be assumed that in one way or the other, even one-half of this sum disappeared in the next twelve months, there would still remain a sum equal to 32 per cent on the capital, available for dividend purposes!

We may be told, also, that most of this $30,000,000 would be placed in a surplus fund, to be used for the benefit of the public in case of a sweeping fire bringing unusual loss. The companies have been providing for this possible calamity for years, by means of greatly inflated surplus funds created by the public, and earning great interest and dividends. But the days of conflagrations, such as swept Chicago thirty years ago, have probably gone and a contingency so remote should not be made the excuse for a perpetual heavy tax of insurance. One of the latest calamities, that which visited Jacksonville, Fla., caused an insurance loss of only $5,932,500. As compared with the surplus above mentioned, surely an insignificant sum.

That the companies themselves do not really worry about the possibilities of sweeping conflagrations repeating the events of thirty years ago, may be gathered from the fact that they do not hesitate to risk their all on the chance of such calamities not being repeated, as witness the congested district of Chicago, where alone $170,000,-000 is at stake. Proportionately large sums are risked similarly, in the conflagration districts of Philadelphia, Boston and other large towns. It will be shown below that even in regard to this conflagration fund the public is being sorely abused.

The full extent of the exploitation to which the public submits is understood only after tracing the origin of the secondary sources of income enjoyed by the fire insurance companies. If we revert to the income and outgo account for the year 1902, we find that over thirteen million dollars out of a total income of $146,000,000 was due to "interests, dividends, rents and other sources." This $13,-000,000 arose from what is generally called the "investment income" in contradistinction to the remainder, the "underwriting income."

The paid-up capital of the companies furnishing this income account amounted to about $47,000,000. This sum was in no wise sunk as it would be if invested in any industry; none of it went into machines, raw material, mines, rolling stock, or right of way. It was, all the time, visible, tangible, dormant in the banks. It was practically a token of good faith, nothing more. By reason of this deposit in the banks, by virtue of this evidence of good faith, the owners of this $47,000,000, by law were permitted to offer insurance against fire and to demand for this insurance such consideration as they pleased and, among themselves, agreed to charge. The public, having accepted these offers of insurance, drew from its pockets considerations, called "premiums," to the amount of over one hundred and twenty-eight million dollars. Of this $128,000,000, there was refunded as indemnity for losses, $64,000,000. The remainder of these premiums, $64,000,000, and the original $47,000,000 which, of course, was intact, belong to the fire insurance companies, by law. They could close their business to-morrow and the public could not say nay.

Instead, the companies left their capital of $47,000,000 in the banks, and out of that part of the premiums not touched by fire they paid dividends and commissions and salaries and taxes, and, as has been seen, had a great fund left over. This fund, amounting to many millions, they placed in the banks, alongside of the untouched capital of $47,000,000, and they called it a surplus fund, put there to pay losses in case the public had another Jacksonville fire.

Now, since the public furnished all the premiums out of which all the losses and all the dividends and all the salaries and all the other items were paid, the surplus, or conflagration fund, was in reality the excess charge demanded of the public over and above what was sufficient compensation for trouble and risk taken; though, if any Jacksonville fire should recur, the indemnity for the fire would be paid out of the accumulated surplus saved out of the public's money, and next year, the public would be further assessed, the "recent conflagration" serving as excuse!

All of this money, all of this excess charge over and above the amount necessary to recompense the custodians and administrators of the public's contributions, should be held in trust as the property of the insuring public. By all moral, ethical, and financial rights, the conflagration fund belongs to the insurers. But it never will be

theirs—unless the law is changed. Instead, this fund will grow, and, growing too big, some fine day it will melt away as an "extra dividend" of 40 or 60 per cent, or else it will amalgamate with the dormant capital of $47,000,000 so that the shareowners will own two shares of stock where now they own but one.

But, it will be said, supposing that the companies owning this capital of $47,000,000 had not been able to pay losses and expenses and dividends out of the contributions of the public, would they not have drawn upon this $47,000,000, their capital? Assume that they had: the inevitable result would be that next year, the public would be forced, willy nilly, to pay enough to make good the impairment of the $47,000,000, and besides that, would be severely taxed for not having in the previous year contributed enough premiums to pay for all its losses and all the commissions, and all the dividends and the sundry items and the conflagration fund.

It is a distinctive feature of these insurance companies that they act as one man, throughout the country, in every town and village. There is no competition among them but, on the contrary, a most exclusive and brotherly *entente cordiale.* Hence, when in the recesses of their council chambers they reach a conclusion, be it right or wrong, that they have "lost money," with hearts that beat as one they set out to seek that which they have lost; and, so far, their quests have been successful.

It is seen that by reason of practically depositing a bond of $47,000,000, fire insurance companies were entrusted with premiums of $128,000,000. Whilst they were the custodians of these premiums, their capital was earning interest, even if only a beggarly 3 per cent. In the same way, the trust fund, the $128,000,000 was earning interest—which interest was retained by the trustees; of course, not interest on $128,000,000 for 365 days, for this trust fund came in gradually, and little by little some of it disappeared for fire and expenses. But a great deal was there all the year. If it be assumed that in view of what was held for the year the whole amount earned an average of 3 per cent, then, $3,840,000 would have been earned as interest or dividends. In the same way, at the end of the year, when the conflagration fund became swollen by the excess of the public's contributions, another source of "interest and dividends" was created.

On the supposition that the above modest sum of $3,840,000 could have been earned, it would of itself have sufficed to pay a

dividend of 8 1-6 per cent on $47,000,000, which dividend, added to the 3 per cent (assumed to be earned by the $47,000,000 lying in the banks) would make 11 1-6 per cent joint interest and dividends. A handsome return on money invested, as investments go to-day!

From the observations immediately preceding, one may gather that the interest earned on the capital, merely deposited in banks, and the interest derived from the use of the public's premiums together produce an income ample enough to enable the companies to renounce all further claims to compensation; that is, to run the underwriting account at bare cost, without a cent of profit.

Underwriting profits such as are insisted upon by the insurance companies are in the nature of extortion, and a display of their underwriting results alone, without a simultaneous display of their investment profits, is a delusion of the insuring public.

The public may view with a certain amount of indifference the fact that it furnishes all the funds that go to indemnify it for losses; that it sacrifices at least one-half of its contributions for the sake of having the remaining half administered; it may contemplate with equanimity the fact that this cost of guardianship is to-day greater than ever before; it may overlook the greed of companies which exact to-day the greatest dividends since 1860; it may know that the recent startling increase in the rates was absolutely unwarranted, and that 20 per cent of the spoils thereof immediately went to brokers, already better paid than ever before. Yet surely the public temper should be stirred when it reflects that it is not even given credit for the serious and persistent efforts which it has made, and continues to make, in the direction of fire prevention and extinction!

In the last thirty years vast improvements in protection have been made by the public: buildings are better constructed; fire-retarding materials and devices have been introduced; fire alarms, watchmen's clocks, automatic sprinklers, chemical fire pails have been put in; water supplies and pumps have been improved; hazards recognized and avoided; better brigades drilled and maintained, better equipments furnished—in fact, the responsible insured have spent huge sums to keep fires down. Fires have been kept down, as the figures show, and yet, the vast expenditures by property owners to protect their premises and cities, so as to avoid fire and to provide for its prompt extinction, have merely resulted in the highest average premium in the last forty-two years. Is it not

evident that there is something woefully defective in the system that brings about such results?

It would be impossible within the space now at command to deal with every aspect of fire insurance deficiencies. An endeavor has been made to show that, viewing the question on its economic or financial side only, the public is being wretchedly exploited. Only a brief indication can be given of how this exploitation is accentuated by the languid attitude of the companies and their agents towards the ethical elements of insurance. It has been shown that the whole fire insurance bill, with the terrible waste and insatiable greed involved, has to be settled by the section of the business community which is responsible and honest. It is one of the worst, one of the most glaring, defects of the present methods of insurance that the insured are not only heavily taxed for the benefit of their trustees, but that, in view of the fact that four-fifths of the fire loss is due to incendiarism and criminal carelessness, the honest and careful must pay heavily for the crime and folly of the unscrupulous and careless.

It is unreasonable that for so many years in succession the fire loss should maintain such huge dimensions. This heavy loss has persisted because of the erroneous principles upon which the business of insurance is conducted. Consider one element alone, the acceptance of a risk: in nearly every case, the desirability of accepting a risk should be gauged by the moral character of the applicant for insurance. The nature of this character, whilst ascertainable by the agent familiar with local conditions, is most often beyond the ken of the companies' head men. The man who is to receive 20 per cent of the premium is naturally not too cautious in regard to the acceptance of risks, and certainly, with this 20 per cent in prospect it would be strange if the benefit of a doubt were not given in his own favor. It is well known that among stock companies no adequate or efficient system exists for checking moral risks, and it is equally well known that the vast majority of fire losses are consequent upon moral laxities of some kind or other, chief among which may be classed gross negligence and carelessness and other preventable conditions. With the great majority of applicants for insurance, the prevailing methods are inadequate to gauge these qualities.

Much loss also could be obviated if the companies sought more actively to eliminate the causes of fire and to increase the facilities

for extinguishing it, rather than to await its scourgings and then to raise prices. The easiest manner of recouping themselves for losses has, of course, been the raising of rates; but this act does not coerce destructive elements and classes into becoming a profitable investment, at least it never has. It merely swells the agents' income and places a heavier burden on the honest insured. The most efficacious means of improving fire conditions is to enlist personal selfishness on the side of fire prevention. As long as a state which invites fire costs for insurance scarcely more than a condition which precludes fire, 50 per cent of the premiums will burn up, each year. For, to-day, most people buy insurance because it allows them to become more careless.

Among heavy insurers, the truth begins to be realized that they have been grouped and allied with innumerable heterogeneous and utterly undesirable elements, for the purpose of paying individual losses out of the common purse. Also, the conviction gains ground that under existing methods of insurance those who, as a class, have an excellent record, and do not burn down, must necessarily pay the indemnity given to those classes who do burn down frequently, whether accidentally or with pleasure aforethought. These heavy insurers, in many instances, have discovered that it is possible to form from among themselves a homogeneous, mutually protective group, rigidly defined in regard to business, moral, and physical hazard. They have thereby set up conditions of mutual service which can be watched and controlled for the best benefit of all concerned. They have not been burdened with the losses arising from elements more dangerous than themselves, whether the dangers were inherent to the business conducted or to the character of the persons engaged therein. The consequence of such action has been that these groups of insurers, associated for mutual helpfulness, have made immense savings whilst securing ample protection. No better illustration of the results obtainable by such organization can be afforded than by the New England Mutuals, which to-day insure over one billion four hundred million dollars' worth of factory property at a net cost of about fourteen cents per $100 of insurance.

Despite the great difficulties of organization and of development attaching to such associations for mutual benefit, despite the spirit of suspicious antagonism often evinced, and the short-sightedness often displayed when the public is asked to bestir itself for

self-interest and common benefit, the business community more and more will protect itself against loss by fire, by forming voluntary associations of men known to each other, engaged in the same business, exposed to the same hazards, and convinced of their individual inability to have "a successful fire." For such as fail to ally themselves under such conditions and for such purposes there will always remain the present method and plan of insurance. However, the dignity of the profession and the public peace of mind call aloud for the introduction of more intelligent, more economical, less distasteful, and less evident methods of exploitation.

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